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C O N F I D E N T I A L SECTION 01 OF 02 HONG KONG 000635

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SUBJECT: CODEL MCCAIN COURTESY CALL ON CHIEF EXECUTIVE TSANG

Classified By: Consul General Joe Donovan for reasons 1.4 (b) and (d).

¶1. (C) Summary: Hong Kong's system, having restructured during the Asian Financial Crisis in 1997, is "resilient", Chief Executive Donald Tsang told CoDel McCain April 5, but the worst may be yet to come. He hoped the United States would not turn to protectionism. Regarding China's proposal for a new reserve currency, Tsang said he envisions an Asian regional currency on a par with the euro or the dollar, but believes the prerequisite is a convertible renminbi. Having "personally secured" the central government's agreement to a timetable for universal suffrage, Tsang believed his biggest challenge was to secure the 2/3 majority he needs from LegCo to advance reform. He believes Asia has not yet found a model for democracy which works, noting how few political leaders in Asia complete their elected terms of office. End summary.

¶2. (C) Chief Executive Donald Tsang hosted CoDel McCain (Senators John McCain, Lindsay Graham, and Amy Klobuchar) and the Consul General at Government House April 5. Tsang told the CoDel "one country, two systems" is now an established part of life, although the people of Hong Kong are still part of one nation. He noted that, in addition to defense and foreign affairs, which are reserved to the PRC, the Hong Kong government must consult with the "sovereign" on issues such as democratic development. Describing the Hong Kong community as Asia's most cosmopolitan, Tsang said his goal was to make Hong Kong the financial center of East Asia as a compliment to London's role for western Europe and New York's role for the Americas.

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Hong Kong "Resilient"; Worst May Be Yet to Come
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¶3. (C) Tsang expressed confidence that the lessons Hong Kong learned during the 1997 Asian Financial Crisis left it in better shape to face the current crisis. Hong Kong had adjusted its regulatory environment and, as a result, its banks remained strong and adequately capitalized. He joked that he had offered banks government assistance, but "they don't want my money." Similarly, the stock markets had not halted for a minute. While there were poor people in Hong Kong, Hong Kong's comprehensive social security system meant no one went hungry and no children or seniors were left vulnerable. Unemployment had risen from 3.5 to 5 percent, but compared with its Asian peers, Hong Kong was still doing well. Hong Kong also remained the largest investor in "each and every one" of China's major cities and provinces, including Beijing and Shanghai.

¶4. (C) That said, he told the CoDel he is prepared for worse to come. Tsang dismissed any notion of "decoupling" of America from Asia, arguing that any manufacturing in Asia inevitably seeks a market in the United States or Europe. Tsang believes the key to recovery will be a successful

adjustment in the U.S. economy accomplished without imposing protectionist measures. The worst thing, he suggested, would be "another Smoot-Hawley."

15. (C) Asked by Senator Graham about China's proposal for a new global reserve currency, Tsang suggested what was needed was in fact an Asian reserve currency similar to the role of the euro in the EU and the dollar for NAFTA economies. In a twenty-four hour cycle, we each work eight hours, he said, so each time zone will likely develop its own reserve currency. However, Tsang sees the prerequisite for such a currency as convertibility of the renminbi, which is not likely in the next decade. Another requirement, Tsang suggested, was that Japan reconcile with its neighbors over questions of World War II history.

Timetable is Fixed in Law

16. (C) Having "personally secured" Beijing's agreement to a timetable on universal suffrage, Tsang noted at several points his conviction that elections by universal suffrage for the Chief Executive in 2017 and for the Legislative Council (LegCo) in 2020 were a done deal. Somewhat contradictorily, however, he noted the difficulty of securing consensus within Hong Kong over what constituted universal suffrage. Of the three required steps to achieve democratic reform -- support of 2/3 of LegCo, agreement by the Chief Executive, and ratification by Beijing, he sees LegCo as the greatest challenge. He noted the paradox that, by insisting that all LegCo seats be directly elected, the current thirty

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directly-elected members were asking the thirty incumbents in the "functional constituencies" (economic and social sectors which elect representatives to LegCo under limited franchise) to agree to their own abolition.

17. (C) Tsang described the Hong Kong system as a modified version of the U.S. system, in that the executive is constituted distinct from the legislature. However, since the Chief Executive cannot be a member of a party, he has no ruling party for support, and must work for support from the entire legislature on each and every vote. Asked by Senator Klobuchar how the systemic conflict could be resolved, Tsang chose to look at Asia as a whole, noting that no Asian country had yet hit on a democratic system which worked. Very few Asian leaders, even in more developed democracies, served out their full terms of office. Even in Korea, presidents were on the defensive six months after taking office, while places like Thailand were actually moving backwards. Under such conditions, Tsang contended, governments spent all their time focused on their immediate political survival. President Bush may not have been popular, Tsang noted, but the American people let him finish his term.

Defending Capital Spending

18. (C) While Tsang agreed with Senator McCain that there was significant waste in capital spending by Japan during its earlier financial difficulties, he argued nevertheless that U.S. infrastructure investment was timely. The United States, Tsang contended, had actually neglected capital infrastructure for years. He himself reported using capital investment in his economic stimulus, saying that Hong Kong's projects aimed to link up Hong Kong and the Mainland in ways which could not exist prior to 1997.

19. (U) The CoDel did not have the opportunity to clear this message prior to departure.
DONOVAN